DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0242
INDIANA CORPORATION INCOME TAX
For Years 1992, 1993, 1994, and 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. **Negative Non-Business Income Claimed by the Taxpayer**: Net Expenses Resulting from Aircraft Accident.

Authority: IC 6-3-1-20; IC 6-3-1-21; IC 6-3-2-1(b); IC 6-3-2-2(a); Atlantic Richfield Co. v. State, 601 P.2d 628 (Colo. 1979); 45 IAC 3.1-1-62.

Taxpayer protests the auditor's determination that a certain loss experienced by taxpayer at its Indiana business site constituted negative "business income" and should have been included within the apportionment formula. Taxpayer asserts that the casualty loss should not be apportioned because it was unique to Indiana, was the result of an unusual and unpredictable event, and because the loss directly impacted the financial results of the Indiana business site.

II. **Apportionment of Partnership Income**: Inclusion of Joint Ventures' Gross Receipts in the Sales Factor.

The taxpayer has protested the decision by the auditor to correct the amount reported by the taxpayer for the sales within Indiana and sales everywhere components of the sales factor. The taxpayer argues that gross sales everywhere needs to be corrected for tax years 1993 and 1995.

III. **Abatement of Ten-Percent Negligence Penalty**.

Authority: IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(b)(2), (4); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

The taxpayer has protested the auditor's determination recommending a ten-percent negligence penalty against all the years of assessment. The taxpayer argues that the penalty should not have been assessed because it fully disclosed and properly determined Indiana adjusted gross income during all relevant tax years.

STATEMENT OF FACTS

Taxpayer is in the hotel and lodging business. Taxpayer operates hotels in various states including a hotel Indiana. The taxpayer's headquarters is located in Missouri.

DISCUSSION

I. Negative Non-Business Income Claimed by the Taxpayer.

In February of 1992, the taxpayer's Indiana business location was the site of a military airplane crash resulting in substantial damage to the taxpayer's property. After the taxpayer completed repairs to its business property and after the taxpayer recovered all related insurance proceeds from the government, the taxpayer sustained a net loss of approximately $491,000. This amount represents the difference between the amount of insurance recovery and the amount the taxpayer spent repairing and rebuilding its Indiana hotel business.

Initially the taxpayer claimed the $491,000 as "negative non-business" income. The auditor found that this decision was erroneous because, according to the auditor, the $491,000 constituted "negative business income" (loss). The taxpayer argues that this particular loss, because it was unusual and unpredictable, occurred at the taxpayer's Indiana location, and because the loss impacted the financial results of the taxpayer's Indiana business site, should not be included in the apportionment formula but should be allocated exclusively to the state of Indiana. According to the taxpayer, the application of the standard three-factor apportionment formula to the loss would result in an unfair tax to the taxpayer's Indiana site when calculating the taxpayer's adjusted gross income tax. Further, the taxpayer argues that applying the standard three-factor apportionment creates an arbitrary division of income and effects an unfair hardship and injustice upon the taxpayer.

Indiana levies adjusted gross income tax on corporate income attributable to Indiana. In order to determine what corporate income is attributable to Indiana, it must first be determined whether the income is business or non-business income. IC 6-3-2-2(a). Under IC 6-3-1-20, "'business income' means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." In contrast, non-business income is defined in the negative and "means all income other than business income." IC 6-3-1-21.

The taxpayer predicates its assertion, that the $491,000 loss should be allocated exclusively to its Indiana business location, upon the unique circumstances under which the loss was incurred. However, under the first of the two tests, which the Department employs to distinguish business and non-business income – the functional test and the transactional test – "the extraordinary nature or the infrequency of the transactions is irrelevant." Atlantic Richfield Co. v. State, 601 P.2d 628, 631 (Colo. 1979). Separated

from the unique circumstances under which the loss occurred, the taxpayer's $491,000 loss is ordinary business income analogous to the proceeds attributable to any ordinary insurance recovery. Separated from the unique circumstances under which the loss occurred, the $491,000 represents a loss directly attributable to the reconstruction of one of the taxpayer's business locations and falls within the classification of income "arising from the taxpayer's trade or business." IC 6-3-1-20. Therefore, the $491,000 loss is properly classified as ordinary business income.

Having made the threshold determination that taxpayer's 1992 loss is ordinary business income, that income becomes subject to the apportionment formula set out in IC 6-3-2-1(b). Specifically, the taxpayer may not adopt a reporting methodology that, in effect, provides for a "separate accounting" of its Indiana operation. Under 45 IAC 3.1-1-62, the Department will allow the taxpayer to "depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute income to this state or other states." Such a departure is warranted only "in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results." Id.

FINDING

The taxpayer's protest is respectfully denied.

DISCUSSION

II. Apportionment of Partnership Income.

Taxpayer operates its business on a calendar year basis with an annual audit prepared and concluded in early May of each year. Thereafter, all state income tax returns -- including taxpayer's Indiana returns -- are filed in advance of the taxpayer's final audited statements and in advance of the final Federal 1120. The data used for taxpayer's state income tax returns are the taxpayer's final numbers pending the annual audit and the final Federal 1120. The auditor, aware of the taxpayer's financial practices, adjusted the taxpayer's state figures to conform with the information on the taxpayer's federal returns as filed. The taxpayer has set forth a generalized argument that the auditor, in adjusting the Indiana returns, erred by failing to include certain receipts derived from hotels in which taxpayer participated as a joint equity partner. Subsequent review of the taxpayer's state and federal returns raises questions concerning the proper characterization of the taxpayer's partnership income and the computation of the taxpayer's sales factor. Given the absence of information which supports a decision to either exclude or include the taxpayer's partnership income, the Department must ask audit to revisit the taxpayer's state and federal returns.

FINDING

Audit is requested to make the aforementioned determinations consistent with the language of this Letter of Findings.

DISCUSSION

III. Abatement of Ten-Percent Negligence Penalty.

Taxpayer requests that the 10% negligence penalty, imposed under the authority of IC 6-8.1-10-2.1(a), be abated. IC 6-8.1-10-2.1(a)(3) imposes on the taxpayer a penalty for a "deficiency that is due to negligence." The penalty is limited to ten-percent of the amount of the tax that was not timely remitted. IC 6-8.1-10-2.1(b)(2), (4). The standards under which negligence is determined and the penalty imposed is found at 45 IAC 15-11-2(b) which states that "'[n]egligence' on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations." The regulation goes on to state that the Department shall determine negligence "on a case by case basis according to the facts and circumstances of each taxpayer." Id.

The Department is authorized to waive the penalty "if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). The regulation provides a non-exclusive list of factors, which go toward establishing reasonable cause, but concludes that "[r]easonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case." Id.

Taxpayer requests abatement of the negligence penalty because it feels it made a good faith effort to accurately file its tax returns. The taxpayer asserts that the calculation of its tax liabilities, given certain unique factual and business circumstances, fairly and accurately reflects its Indiana income.

Taxpayer requests abatement of the negligence penalty based upon general equitable principles. However, absent concrete and specific factual indicia upon which to substantiate the taxpayer's request, the Department must decline the opportunity to abate the assessed penalties.

FINDING

Taxpayer's protest is respectfully denied.